

Federal and State Tax Consequences of the Windsor Decision Striking Down DOMA

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On June 26, 2013, the United States Supreme Court struck down the federal Defense of Marriage Act (“DOMA”) as a violation of the Fifth Amendment to the U.S. Constitution, see United States v. Windsor, 570 U.S. ___, 133 S. Ct. 2675 (2013). *Windsor* creates tremendous uncertainty among taxpayers and tax preparers alike regarding its effect on income tax filing and reporting. The Internal Revenue Service (“IRS”) has proactively provided guidance on *Windsor*’s application to tax filings and benefits practices. However, given the unprecedented nature of this decision and the ripples it will have throughout federal law (there are more than two hundred federal tax code provisions and Treasury regulations involving spouses and marriage), some traps for the unwary remain and practitioners should carefully address each in turn as part of the year-end tax planning process.

Individual Income Tax Consequences

Filing as Married

Following *Windsor*, the IRS announced that any couple which was legally married in a jurisdiction (domestic or otherwise) recognizing same-sex marriages will be considered married for all federal tax purposes, regardless of whether the taxpayers’ current jurisdiction recognizes the validity of same-sex marriage. The IRS will not recognize a registered domestic partnership, civil union, or any other similar formal relationship. Accordingly, the first step is to determine where and when such clients were married and whether same-sex marriage was legal in the jurisdiction where the ceremony was performed. If there is uncertainty regarding the taxpayers’ marital

status, clients should be counseled to consult with a domestic relations attorney to determine whether the taxpayers’ marital status will be recognized by the IRS.

Filing Amended Returns

When a statute is deemed unconstitutional, as DOMA was in *Windsor*, the statute is treated as if it had been unconstitutional and unenforceable since the day it was passed. However, the IRS has the authority to determine whether a judicial decision will have retroactive effect with respect to the Internal Revenue Code. As announced in Revenue Ruling 2013-17, the IRS has decided that *Windsor* will be applied prospectively beginning September 16, 2013; all tax returns filed by same-sex married couples after that date must be filed as ‘married’ or ‘married filing separately’ and taxpayers may need to provide employers with a new IRS Form W-4. In addition, *Windsor* will be given retroactive effect to the extent of any open periods as determined by Section 6511 of the Code. Section 6511 permits amended returns to be filed with respect to any tax return within the later of (i) three years from the date the return was filed, including extensions, or (ii) two years from the date the tax was paid. The retroactive effect of *Windsor* is only applicable if the couple was married at some point during the year at issue.

To amend or not to amend, that is the question. Married same-sex couples have no duty to amend prior returns. However, amending prior returns for open years will allow taxpayers to exclude, as a pre-tax salary reduction, amounts paid with respect to employer-provided health coverage benefits or fringe benefits that were provided to

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the taxpayer's spouse. To date, these amounts have been paid by the taxpayer on an after-tax basis due to DOMA. Couples that are high-earners or earn relatively similar amounts may find that the so-called "marriage penalty" outweighs the benefits of filing amended returns. Amended returns will be filed on IRS Form 1040X.

TIP: Taxpayers should reference *Windsor* in the top margin of the first page of the return or in an attachment to the return as a protective measure if previously reported tax information, such as the taxpayer's W-2, does not match the information in the amended return. All items reported on the amended return which are affected by marital status must be adjusted to reflect the marital status reported on such return.

TIP: Taxpayers can choose to amend some, but not all, of the open periods if only one or two of the periods will prove to be advantageous for the taxpayer.

State Income Taxation

For New Hampshire state tax purposes, married same-sex couples will benefit from a combined \$4,800 exemption under the Interest & Dividends Tax and sole proprietors will be entitled to include their spouse in the compensation deduction taken under the Business Profits Tax, provided the spouse actually performed services for the business. For residents of states with a state income tax, it may be possible for those taxpayers who are amending their federal income tax returns to amend their state income tax returns as well.

TIP: States that do not recognize same-sex marriage need not follow the federal tax law guidance. All New England states recognize same-sex marriage. However, other states' income tax filings may not match the federal return protocol. Those states, and practitioners, will need to address this disconnect.

Other Individual Taxes

In addition to income tax benefits, married same-sex couples will now also benefit from use of the combined exclusion for capital gains on the sale of a primary residence, gift-splitting and the portability provisions relating to the estate tax.

Employer-Related Matters

Revenue Ruling 2013-17 also addressed income taxation and tax qualification provisions of certain employer plans.

TIP: Although full guidance is not yet issued, we know that certain changes are required as of September 16, 2013.

Income Taxation of Employer-Provided Benefits

Prior to *Windsor*, certain benefits provided to the spouses of same-sex employees were includible in gross income or wages for federal income or employment tax purposes. Revenue Ruling 2013-17 clarified that, beginning on September 16, 2013, employers must apply *Windsor* prospectively to exclude such benefits for income and

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employment tax purposes. September's IRS Notice 2013-61 explained how employers may file for changes in withholding and employment tax payments for the first three quarters of 2013 and prior years, given the decision's retroactive effect for open periods. These special optional administrative procedures allow employers to utilize Form 941 or 941-X to report adjustments or corrections due to *Windsor*. All other adjustments must be made following usual IRS procedures.

Retirement and Welfare/Health Plans

The IRS is still in the process of determining how to apply *Windsor* to other employee benefits and employee benefit plans and arrangements. Upcoming guidance is expected to provide information on plan amendments and corrections necessary for qualified plans to remain qualified, and thus retain favorable tax treatment. In the meantime, however, retirement plan operation must comply with existing guidance – defining “spouse” to include same-sex spouses for such purposes as loan and hardship provisions, preretirement survivor annuity benefits and beneficiary designation provisions – all as of September 16, 2013.

TIP: pension plans may be required or elect to recalculate in-force annuity payments to retirees whose marriage is newly-recognized.

Unlike the effect on retirement plans, the effect of *Windsor* on health and welfare plans is not so absolute. Employers have more flexibility in determining eligibility for health plans v. retirement plans, which are subject to a mixed combination of state and federal law that varies depending on the benefit's funding (fully insured? self-

insured?) and the employer (secular entity? religious entity?).

TIP: Employers should carefully examine existing health benefit provisions – especially the definition of “spouse” – to understand each plan's post-*Windsor* operation and exposure and determine if HIPAA's special enrollment period will apply.

What's Next?

Impressively, the IRS has quickly provided streamlined procedures for implementing *Windsor* for current and prior years. We should still, though, expect some bumps in the road. For example, *Windsor*'s application to the Code's attribution rules may render certain estate-planning and other types of previously taxable transfers between same-sex spouses either invalid or no longer subject to tax if enforced. Employer plans may inadvertently break their own rules by failing to adjust their procedures in compliance with *Windsor* guidance after September 16, 2013. The IRS has indicated it will be forgiving, but plan sponsors may still be assessed a fee for a plan correction. These and other wrinkles may trigger audits.

We are available to help you help your clients navigate their way through these early stages of a new tax and benefit regime.

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